BEFORE THE
FEDERAL COMMUNICATIONS COMMISSION
WASHINGTON, D.C. 20554

In the Matter of	)	
Request to Update Default Compensation Rate for	)	WC Docket No. 03-225
Dial-Around Calls from Payphones	)	RM No. 10568

RBOC PAYPHONE COALITION'S COMMENTS ON NOTICE OF PROPOSED RULEMAKING

INTRODUCTION AND SUMMARY

The RBOC Payphone Coalition ("the Coalition")[1] files these comments in response to the Notice of Proposed Rulemaking in the above-captioned proceeding.

I. A. The Commission should maintain the basic methodology that it adopted in the *Third Report and Order*.[2] By basing the default compensation rate on the per-call costs of coinless calls at a marginal payphone, the Commission promotes the statutory goals of widespread deployment and fair compensation. The D.C. Circuit has approved this methodology as consistent with the statute. The minor methodological change is in the calculation of marginal call volumes. Under the Commission's prior methodology, marginal call volumes were derived from marginal revenue requirements, a method that made marginal call volume depend on the compensation rate for coinless calls – the very thing the Commission is trying to determine. By contrast, the methodology the Coalition has proposed – that is, deriving marginal payphone call volumes based on actual *average* call volumes, adjusted to exclude calls

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[1] The Coalition includes the payphone operations of the Verizon telephone companies and SBC Communications Inc.

[2] Third Report and Order and Order on Reconsideration of the Second Report and Order, *Implementation of the Pay Telephone Reclassification and Compensation Provisions of the Telecommunications Act of 1996*, 14 FCC Rcd 2545 (1999) ("*Third Report and Order*").

supporting payments of commissions to location owners at supra-marginal locations – will ensure that the per-call compensation amount is based on objective market conditions.

B. The Commission cannot allocate joint and common payphone costs based on differing elasticity or cross-elasticity of demand for various types of payphone calls. In the *Third Report and Order*, the Commission determined that as a matter of equity, common costs should be allocated proportionately among all call types. Moreover, the Commission determined that it lacked sufficiently reliable data to adjust common cost allocation based on relative elasticities of demand. There is no basis for revisiting those conclusions here.

C. The Commission should reject yet again Sprint's request for a "caller-pays" regime, which would conflict with the statute, suppress call volumes, and inconvenience payphone users.

II. The $0.49 rate proposed by the Coalition in its petition for rulemaking is, if anything, conservative, and the Commission should adopt it. More recent studies show that the trends identified in that study – declining call volumes, decreasing deployment, decreasing marginal volumes, and decreasing per-station costs – have all continued. There is no basis for adjusting the depreciation rate used in the *Third Report and Order*. The estimated equipment cost is conservative, even for the mix of new and refurbished equipment Coalition members use. The Coalition submits that the bad debt element in its 2001 study – which reflects experience under the same type of reseller-pays regime that the Commission established in its most recent order on the subject – is likewise appropriate and supported by solid data. The Commission should take account of revenues associated with additional services (principally advertising) that benefit PSPs; these are reflected in the Coalition study.

DISCUSSION

I. THE COMMISSION SHOULD MAINTAIN THE METHODOLOGY OF THE *THIRD REPORT AND ORDER*

A. The Commission Should Set the Per-Call Default Rate Based on Per-Call Costs at a Marginal Payphone

The Coalition has explained in its petition and in its reply comments the reasons that the Commission should retain the cost-based methodology established in the *Third Report and Order* to determine the new default rate for per-call compensation. The Coalition therefore supports the Commission's tentative conclusion in this regard. *See NPRM* ¶ 27. Indeed, because the Commission's methodology was affirmed on review by the D.C. Circuit, there can be no obstacle to the Commission employing the same methodology and recalculating the default rate based on current market and cost data. *See American Pub. Communications Council v. FCC*, 215 F.3d 51 (D.C. Cir. 2000).

In particular, the Commission should continue to set the per-call rate based on the costs and call volumes at a marginal payphone. The Commission's stated purpose for adopting the marginal payphone as the basis for its per-call compensation calculation was to "promote the continued existence of the vast majority of payphones." *Third Report and Order*, 14 FCC Rcd at 2571, ¶ 59. "[B]asing the default compensation amount on an average payphone location would cause many payphones with less-than-average call volumes to become unprofitable." *Id.* at 2608, ¶ 141.

As the Coalition has also explained, however, the Commission should make a slight modification to the methodology set forth in the *Third Report and Order* for determining marginal payphone call volumes. In the *Third Report and Order*, the Commission based its calculation of the marginal payphone call volumes on revenue requirements reported by the RBOC Payphone Coalition. *Id.* at 2612, ¶ 147. The Coalition had used revenue requirements

for a marginal location reported by Coalition members to derive a call volume for that marginal location, based on prevailing per-call compensation rates. The Coalition has not used the same methodology in the current cost studies, because whether a payphone is marginal depends on the rate of compensation paid for all of the calls made from the payphone. In a market with sharply declining call volumes, whether a marginal payphone will remain marginal depends on whether and by how much the per-call compensation rate is increased. That is, the higher the per-call compensation rate that the Commission sets, the fewer calls that would be required to support a marginal phone, and *vice versa*. To avoid the potential circularity in the Commission's prior method, the Coalition, as explained more fully below, has derived marginal call volumes based on actual average call volumes, excluding those calls supporting payment of commissions to location owners at supra-marginal locations.

Market facts illustrate the need to modify the Commission's methodology in this regard. Although the Commission intended to set a per-call rate that would "ensure the widespread deployment of payphones in compliance with the mandates of section 276," *id.* at 2608, ¶ 141, the number of RBOC phones has fallen by approximately 40% – from 1.38 million in 1997 to 1.06 million in 2001 to fewer than 800,000 today, *see* KPMG, Calculation of Per-Call Compensation Rate, RBOC Payphone Coalition at 11 (Jan. 6, 2004) ("KPMG Report") (attached as Ex. 1). As the Commission feared, and despite the Commission's effort to determine the call volume at a marginal phone, "many payphones [have] become unprofitable and [have] exit[ed] the industry." *Third Report and Order*, 14 FCC Rcd at 2608-09, ¶ 141. They have become unprofitable – despite the fact that PSPs have raised local call rates in an attempt to stem declining revenues – in large measure because PSPs have not had the benefit of any increase in the per-call compensation rate. Thus, to determine an appropriate default rate, the Commission

should look at current *actual* call volumes in order to determine the per-call revenue requirement for payphones that are still deployed.

The Coalition has therefore calculated call volumes at a marginal payphone by adjusting the call volume at an *average* payphone location to exclude calls supporting payment of commissions to location owners (and to account for revenues from semi-public payphones). This calculation is consistent with the Commission's definition of the marginal payphone as one that "earns just enough revenue to warrant its placement, but not enough to pay anything to the premises owner." *Id.* at 2615-16, ¶ 156. The number of calls at a marginal location, according to the Commission's definition, is thus equal to the number of calls at the average location minus the number of calls required to pay the average location rent. The Commission followed a similar approach to calculate the call volume at a marginal payphone location in the *Second Report and Order*,[3] 13 FCC Rcd at 1798-99, ¶ 48, and that methodology was never challenged.

By calculating the marginal payphone call volume in this way, the Commission can ensure that dial-around and toll-free calls are making the appropriate *pro rata* contribution to recovery of payphone costs under current (or, at least, recent) market conditions, as the Commission intended. While continuing declines in the number of payphone calls indicate that a new default rate may be compensatory for only a short period of time, quick action on the *NPRM* will at least ameliorate the current shortfall in compensation, and perhaps stem somewhat the sharp drop in the number of payphones deployed nationwide – a drop that is directly contrary to the congressional desire for "widespread deployment of payphone services."

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[3] Second Report and Order, *Implementation of the Pay Telephone Reclassification and Compensation Provisions of the Telecommunications Act of 1996*, 13 FCC Rcd 1778 (1997) ("*Second Report and Order*").

B. The Commission Cannot Allocate Joint and Common Costs Based on Relative Price Elasticities of Demand

The Commission has sought comment on whether, "due to the elasticity of the demand for dial-around calling," the Commission should modify the rate-setting methodology it adopted in the *Third Report and Order*. *NPRM* ¶ 28. The Commission stated that "elasticity issues bear on both the allocation of overhead and the potential for demand suppression" and sought "further comment on the issue of demand elasticity . . . and the cross-elasticity of demand between payphones and wireless telephone service." *Id.* In fact, consideration of demand elasticities should not come into play in the per-call compensation rate-setting methodology.

In the *Third Report and Order*, the Commission determined that the default per-call compensation amount should "ensure that each call at a marginal payphone location recovers the marginal cost of that call plus a proportionate share of the joint and common costs of providing the payphone." 14 FCC Rcd at 2571, ¶ 59. That decision was based in part on the determination that "fair compensation require[s] that dial-around calls contribute a proportionate share of the common costs of payphone service" because "any other approach would unfairly require one segment of payphone users to disproportionately support the availability of payphones to the benefit of another segment of payphone users." *Id.* at 2570, ¶ 57. Thus, the Commission determined, as a matter of equity, that each class of payphone user should bear a proportionate share of common costs.

But even leaving those equity concerns aside, there is no basis for allocating common costs based on demand elasticities in this case. As a matter of economic *theory*, it would likely be efficient to allocate a higher percentage of common costs to those services for which demand is most inelastic; such a rate-making approach would better approximate the result that would be reached by the free market. *See generally* Comments of the RBOC/GTE/SNET Payphone

Coalition, CC Docket No. 96-128, at 20-24 (filed Aug. 26, 1997) ("Coalition 1997 Comments"). But, as the Commission found in the *Third Report and Order*, "Ramsay" or "inverse elasticity" pricing would depend in this case on having more accurate estimates of marginal cost and price elasticity of demand for various types of calling than is available. *See, e.g., Third Report and Order*, 14 FCC Rcd at 2583, ¶ 86 ("We do not believe that we can obtain sufficiently accurate marginal cost and elasticity estimates to use a Ramsey's-style pricing mechanism."). Without such information, the Commission could not allocate a greater proportion of common costs to any particular payphone service.

Likewise, there is no basis for incorporating consideration of cross-elasticity of demand with wireless telephone service into the rate-setting methodology in this case. Not only is such cross-elasticity data likely to be difficult to estimate, but it is also even more unlikely that the Commission could reliably distinguish between the cross-elasticity of demand between local coin calls and local wireless calls, on the one hand, and the cross-elasticity of demand between compensable calls from payphones and similar calls from wireless telephones, on the other.

There is no dispute that the per-call compensation rate must be set with the goal of ensuring that PSPs are able to recover all of the costs of providing payphone service; otherwise, such a rate will contribute to the removal of payphones, contrary to congressional intent to promote widespread payphone deployment. *See* Coalition 1997 Comments, Hausman Decl. ¶¶ 19-21. The Commission's failure to increase the per-call compensation rate, in the face of declining call volumes, means that PSPs have been forced to recover an increasing share of common costs from local callers, with the market rate for such calls generally having increased from $0.35 to $0.50. As a matter of equity and efficiency, therefore, it is a matter of urgency that

the per-call rate be increased, to ensure that all payphone users bear a fair proportion of common costs.

Interexchange Carriers ("IXCs") have argued that an increase in the per-call rate will depress demand for dial-around calls, and, to some extent, this is likely true – no one claims that demand is perfectly *inelastic*. But that truism does not provide any basis for leaving the per-call compensation rate where it is: to the contrary, as per-call costs increase, the per-call rate must increase as well. There is no reason to believe that an increase in the per-call rate will accelerate any decreases in total revenue – to the contrary, it is the Coalition's strong belief, based on experience with increasing the local coin rate, that an increase in the per-call rate will help to preserve revenue. Of course, in the extremely unlikely event that the increase in the per-call rate accelerates the decline in per-call compensation revenues, the PSPs themselves would have every incentive to negotiate a lower rate, and they should remain free to do so. *See Third Report and Order*, 14 FCC Rcd at 2580, ¶ 78 ("Payphone owners may, of course, determine that contracting with IXCs to receive a lower amount will attract more dial-around traffic and thus increase their profits.").

In the end, the IXCs' argument as to elasticity amounts to urging the Commission to perpetuate what amounts to cross-subsidization of IXCs and their customers by local coin callers. Payphone usage has decreased *overall* and for all types of calls. When the IXCs argue that decreased usage should lead the Commission to maintain the same dial-around compensation rate, what they are really suggesting is that the joint and common costs of payphones should be met by *increasing* the local coin rate *even further*. This, of course, would harm local coin callers, exacerbate the disproportionate cost recovery that characterizes the present rate structure, and further suppress demand for local calling. Given the paucity of data about demand

elasticities in the record, it is entirely possible that this result would depress demand far more than an increase in the per-call rate; indeed, that is what the data introduced by the Coalition in 1997 showed.

The Commission has already decided that all calls should bear the same proportion of common costs. It should not change that approach.

C. The Commission Should Again Reject "Caller Pays"

The Commission should reject (for at least the third time) any type of "caller-pays" methodology. The Commission should instead adhere to its tentative conclusion that such a methodology would be contrary to the statute and undesirable as a matter of policy.

First, Congress has, for all practical purposes, prohibited the use of advance payment systems, regardless of the putative policy benefits from such an approach. *See* 47 U.S.C. § 226(e) (requiring the Commission to ensure that payphone operators allow customers to use access codes to access long distance services); 47 U.S.C. § 226(c)(1)(B) (requiring payphone providers to allow the use of access codes). As the Commission itself recognized in the *Third Report and Order*, it lacks the authority to promulgate a caller-pays rule. *Third Report and Order*, 14 FCC Rcd at 2565, ¶ 42 (noting that a caller-pays approach "appears to contradict congressional directives set forth in other sections of the Act").

Second, even if a caller-pays system were permissible, it would likely anger consumers who have come to depend on the ability to make toll-free and access code calls from payphones without any advance payment. The Commission's prior conclusion – affirmed by the D.C. Circuit – that coinless calling is a convenience upon which the public has come to rely is equally relevant in the present market. *See Illinois Pub. Telecomms. Ass'n v. FCC*, 117 F.3d 555, 567 (D.C. Cir. 1997).

Third, the Commission itself has recognized that "a caller-pays system would impose significant extra transactions costs on payphone users because they would have to either insert coins or enter another credit card number in order to make these types of calls." *Third Report and Order*, 14 FCC Rcd at 2565, ¶ 42. Imposing additional transaction costs would depress payphone usage even further.

II. THE COMMISSION SHOULD RETAIN MOST EXISTING COST CATEGORIES AND TAKE MORE RECENT DATA INTO ACCOUNT

A. The Commission Should Set the Per-Call Rate at $0.49

The Coalition submitted a thoroughly documented cost study, attached to its petition for rulemaking, establishing that the costs of compensable calls had risen to $0.49 per call. The Coalition believes that the Commission should set the per-call default rate at $0.49.

The Coalition has updated its cost study to verify that the $0.49 rate does not overstate per-call costs. The new study demonstrates that, far from having fallen, per-call costs have continued to rise. All of the trends evident in the Coalition's earlier cost study – steady or declining per-station costs, declining payphone deployment, and declining average and marginal call volumes – continue unabated. Thus, monthly per-station costs for the nine months ended September 30, 2003, have decreased slightly compared to the Coalition's earlier study, from $94.67 to $90.01; payphone deployment has decreased from 1.06 million to 783,200; and marginal call volumes have declined from 219 to 166. This leads to a per-call cost figure higher than the $0.49 figure supported by the prior study.

Nevertheless, the Coalition does not seek an increase in the per-call compensation rate above $0.49. The Coalition believes it is appropriate to allow the prevailing local coin rate to set a ceiling for the dial-around rate, since it provides a market indication of what payphone providers would charge for use of their payphones in the absence of the regulatory distortions

that prevent the operation of the market in the case of dial-around calls. Accordingly, while per-call costs of dial-around calls continue to rise, the Coalition requests an increase in the per-call rate to $0.49.

B. The Commission Should Take Account of Bad Debt, Collection Costs, and Incidental Revenues But Should Not Otherwise Modify Its Cost Categories

In the *Third Report and Order*, the FCC used five categories of costs, plus interest, in calculating per-call costs. One of those – FLEX ANI costs – should have been recovered (though in fact it likely was not, *see* KPMG Study at 7) and no longer applies. Four of those categories – payphone capital expense, line costs, maintenance costs, and SG&A costs – should be retained and updated. In addition, the Commission should add two additional related categories of costs and take account of offsetting revenue.

First, the Commission has no basis for modifying the very conservative estimate of payphone capital expenses contained in the *Third Report and Order*. *See NPRM* ¶ 29. The Coalition cost study found no change in the costs associated with the payphone enclosure, pedestal, associated spare parts, and installation. Moreover, based on Coalition experience, the 10-year depreciation period is conservative; Coalition members generally depreciate payphone investment over a 5-8 year period. Nor is there any basis for decreasing the estimated cost of payphone equipment. Although Coalition members use both new and refurbished equipment for new installations, the Commission used an unrealistically low estimate of payphone costs by basing its prior cost estimate on a type of payphone instrument that no Coalition PSP uses and that cost only $225 per station. Accordingly, reliance on the Commission's prior figure for per-station capital costs is appropriate.

Second, the Commission should add line items for bad debt and carrier identification costs associated with collection of per-call compensation. *See NPRM* ¶ 30. The Commission

previously declined to include bad debt and carrier identification costs in its cost calculations, not because they are not appropriate costs – there can be no doubt that they are[4] – but because there was insufficient information regarding these costs. Since the *Third Report and Order*, however, PSPs have collected reliable data relating to bad debt and have documented costs related to identifying carriers obligated for payment of per-call compensation. The data reflected in the Coalition's cost study was collected at a time when a reseller-pays rule, similar to the rule the Commission recently adopted, was in place. The data therefore provides a very accurate estimate of what the Coalition's bad-debt experience is likely to be under the current regulatory regime.[5] Moreover, the Coalition's cost study bases its bad debt calculation only on actual write-offs, thereby avoiding the potential problem of double recovery that the Commission previously identified.

Third, the Coalition cost study included cost and call volume data from semi-public phones, that is, phones for which the premises owner had a particular need. *See NPRM* ¶ 31.

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[4] The Commission and the courts have frequently recognized that bad debt or uncollectible expense is a recoverable cost. *See, e.g., Cable & Wireless P.L.C. v. FCC*, 166 F.3d 1224, 1232 (D.C. Cir. 1999) (affirming FCC's methodology for international call compensation system, which included a line item for "uncollectible billings"); Proposed First Quarter 2004 Universal Service Contribution Factor, CC Docket No. 96-45, 2003 FCC LEXIS 6733 (rel. Dec. 4, 2003) (allowing one percent adjustment for uncollectibles in Universal Service contribution factor); Policy Statement, *Verizon Petition for Emergency Declaratory and Other Relief*, 17 FCC Rcd 26884, 26982, ¶ 15 (rel. Dec. 23, 2002) (noting that because "incumbent LEC uncollectibles generally have increased in the past two years," it "may be reasonable for incumbent LECs to seek more protection from risk of nonpayment than the protections provided in existing tariffs"); Order, *BellSouth Telecommunications, Inc., Tariff FCC No. 1, Transmittal No. 657*, 17 FCC Rcd 17256, 17256, ¶ 2 (2002) ("Existing incumbent local exchange carrier (LEC) interstate access tariffs contain protections for uncollectibles."); *Investigation Into Rates for Unbundled Network Elements Pursuant to the Telecommunications Act of 1996*, 2003 Md. PSC LEXIS 25, at *54 (June 30, 2003) (including a factor for uncollectibles in UNE rates); *Joint Complaint of AT&T Communications of New York, Inc.*, 1998 N.Y. PUC LEXIS 433, at *45 (July 15, 1998) (same).

[5] Bad debt and carrier identification costs under the "toll-gate" regime decreased from $0.040 per call to $.025 per call. Unfortunately, because the Commission has reverted to a reseller-pays regime, bad debt expense will likely rise to its former level.

Call volumes from such semi-public phones tend to be lower than for public phones, but premises owners also may make payments to the PSP to offset a portion of the PSP's costs. For that reason, it was important to include semi-public revenues in the cost calculation. In addition, PSPs have a small amount of other incidental revenue, including station advertising. Those revenues offset payphone costs, and therefore are included in determining the revenues PSPs require to recover total payphone costs.

CONCLUSION

The Commission should adhere to the methodology of the *Third Report and Order* and set a new dial-around compensation rate of $0.49 per call.

Respectfully submitted,

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January 7, 2004

Exhibit 1

Calculation of Per-Call Compensation

RBOC Payphone Coalition

January 6, 2004

Calculation of Per-Call Compensation

KPMG LLP ("KPMG") was asked to update information included in our previous cost-study for the RBOC Payphone Coalition, which includes SBC Communications Inc. and the Verizon telephone companies, in order to determine a proposed per-call payphone compensation ("PCC") rate based on the cost calculation methodology outlined in the Federal Communications Commission's ("FCC") Third Report and Order in CC Docket No. 96-128[1] and affirmed on review in American Public Communications Council v. FCC, 215 F.3d 51 (D.C. Cir. 2000).

KPMG's previous cost-study resulted in a PCC rate of $.49 based on financial and operational data from the month of August 2001. The updated ("current") cost-study produces a PCC rate of $.59 based on financial and operational data from the nine-month period ended September 30, 2003. The methodology and data collection processes used in the current cost-study were congruent to those used in the previous cost-study.

Working directly with personnel from each of the RBOC Payphone Coalition members, as well as with personnel from BellSouth Public Communications, Inc. ("BellSouth Public") and Qwest Communications International Inc. ("Qwest"), KPMG gathered financial and operational data associated with each of the above carriers' payphone businesses. The types of data gathered during the cost-study included:

- Equipment Costs
- Line Costs
- Maintenance Costs

[1] Third Report and Order, and Order on Reconsideration of the Second Report and Order, *Implementation of the Pay Telephone Reclassification and Compensation Provisions of the Telecommunications Act of 1996*, 14 FCC Rcd 2545 (1999) ("3rd R&O").

- Selling, General & Administrative ("SG&A") Costs
- Net Commissions (Location Rents and Semi-Public Revenues)
- Incidental Revenues (Payphone Booth Advertising)
- Bad Debt
- Dial-Around Carrier Identification Costs
- Number of Stations (Payphones)
- Number of Payphone and PCC Calls

This current cost-study utilized data from the nine-month period ended September 30, 2003 (January 1, 2003 to September 30, 2003) to calculate the updated PCC amount. This time period represents the most current available financial and operational data as of the end of a calendar quarter for the RBOC Coalition members, BellSouth Public, and Qwest.

In addition, this nine-month period provides a relatively normalized quantification of revenues, costs, number of payphones and total PCC-eligible calls, as seasonal and cyclical trends would be captured. Finally, during our review of the data submitted we did not encounter any evidence that would lead us to believe that the revenues and costs associated with operating payphone business units on a per-payphone or per-call basis during the nine-months ended September 30, 2003 are not reflective of those incurred in any other monthly, quarterly or annual time period.

A. Components of Cost Based Per-Call Compensation

Equipment Costs

The costs associated with a working payphone include the costs of the payphone unit and the enclosure, pedestal and associated spare parts, as well as other capital costs, including installation (adjusted for coin mechanism installation costs), as outlined in the 3rd R&O. In the 3rd R&O, the FCC calculated the capital cost of a payphone unit using three steps:

- Estimating the cost of an AT&T 11A coinless payphone,
- Estimating the remaining costs of the payphone unit, including those documented above, and
- Calculating the monthly payments that would cover the payphone and remaining costs over a 10-year period, including taxes calculated at a composite rate of 39.25% and interest computed using the FCC's authorized after-tax rate of return of 11.25%.

For purposes of our cost studies, we worked with the RBOC Payphone Coalition, BellSouth Public and Qwest to determine if these costs for newly installed payphones had changed significantly from the amounts detailed in the 3rd R&O. Our review indicated that they had not. We also investigated the typical period for depreciation of payphone station assets and determined that the 10-year period used in the 3rd R&O is conservative: RBOC Payphone Coalition members, BellSouth Public, and Qwest typically depreciate payphone station assets over a period of 5 or 8 years. While the cost of a new AT&T 11A payphone was no longer identifiable, in the previous cost-study we were able to determine that a similar unit, the AT&T 11B coinless payphone, cost $250, $25 more than the $225 cost used in the 3rd R&O. In addition, RBOC Payphone Coalition members, BellSouth Public and Qwest indicated that the

remaining equipment-related costs had not changed significantly since the 3rd R&O. As such, we used the $28.04 monthly payment amount from the 3rd R&O in both our previous and current cost-studies.

Including the additional $25 for the payphone unit would have increased the monthly payment amount by $.45 to $28.49, as calculated on a present-value basis below:

	Current Cost Study	3rd R&O
Cost of Coinless Payphone Unit	$250.00	$225.00
Remaining Cost	$1,362.50	$1,362.50
Less: Coin Mechanism Install Costs	($60.00)	($60.00)
Total Costs	$1,552.50	$1,527.50
Number of Payment Years	10	10
Interest	11.25%	11.25%
Taxes (Federal, State and Local)	39.25%	39.25%
Monthly Payment	$28.49	$28.04

Line Costs

In order to calculate the joint and common line costs associated with payphones, we employed the methodology outlined by the FCC in the 3rd R&O. In order to do so, it was necessary to segregate the line costs based on pricing options. The pricing of payphone lines falls under one of three categories:

- Unlimited service, consisting of a flat monthly fee, regardless of usage,
- Measured service, which consists of a lower monthly flat fee plus a usage-based pricing component (per-call or per-minute), or
- A choice between unlimited and measured service.

Based on the type of service selected and the pricing options provided by the local exchange carrier ("LEC") servicing the applicable common line, line costs are considered joint and common as follows:

- When unlimited service is the only option provided by the LEC, the entire line cost amount is considered joint and common.
- When measured service is the only option provided by the LEC, only the monthly recurring flat fee is considered joint and common.
- When the LEC provides a choice between unlimited and measured service, only the monthly recurring flat fee associated with the measured service option is considered joint and common.

Based on the data collected from the RBOC Payphone Coalition members, BellSouth Public, and Qwest, we aggregated the costs associated solely with the monthly recurring charges for

unlimited and measured services, and excluded any usage-based costs. As a result, for the current cost-study the average joint and common line costs were calculated to be $34.84 per payphone per month. This represents an increase of 3.5% from the $33.65 calculated by the FCC in the 3rd R&O and a decrease of 8.0% from the $37.86 calculated in the previous cost-study.

Maintenance Costs

In determining the joint and common maintenance costs associated with payphones, the FCC, in the 3rd R&O, found that the change in maintenance costs varies insignificantly with the number of coin calls and that maintenance is usually performed during regularly scheduled visits, and are therefore considered joint and common. However, the FCC noted that coin collection costs and maintenance related strictly to the coin function are not considered joint and common, and should be excluded from maintenance costs.

The maintenance costs collected from the RBOC Payphone Coalition, BellSouth Public, and Qwest for the cost-study were adjusted to exclude coin-related costs, including relevant salaries, wages and benefits, coin collection activities, coin collection centers, counting centers, shipping of coins and coin-only related maintenance visits. Using that data, for the current cost-study the average joint and common maintenance costs were calculated to be $9.67 per payphone per month. This amount is 48.8% less than the $18.90 calculated by the FCC in the 3rd R&O and 30.0% less than the $13.81 calculated in the previous cost-study.

SG&A Costs

In the 3rd R&O, the FCC found that total SG&A costs were considered joint and common, as there was no credible evidence that these costs change materially based on the mix of coin and coinless calls.

The SG&A costs we collected from the RBOC Payphone Coalition, BellSouth Public, and Qwest for the cost-study were adjusted, however, to exclude certain items identifiable as related solely to coin calls. In addition, we excluded certain allocations of corporate personnel and other costs from the SG&A amounts, as they were immaterial (though allowable under the 3rd R&O). The average joint and common SG&A costs in the current cost-study were calculated to be $18.20 per payphone per month. This amount is a decrease of 7.2% from the $19.62 calculated by the FCC in the 3rd R&O and an increase of 18.9% from the $15.30 calculated in the previous cost-study.

FLEX ANI Costs

Although FLEX ANI costs were considered joint and common, they were not included in the previous or current cost-studies. In the 3rd R&O, the FCC found that the average payphone owner would pay $1.08 per payphone per month for 36 months, due to the FLEX ANI. Under this scenario, these costs would have been recovered by payphone owners under the current $.24 PCC rate, applied retroactively to October 7, 1997. Although we did not attempt to calculate the impact of FLEX ANI costs on the PCC rate, it should be noted that the substantial decrease in the number of payphone calls over the past few years would suggest that the RBOC Payphone Coalition members and Qwest were unable to fully recover FLEX ANI costs.

Net Commissions: Commission Costs / Location Rents and Semi-Public Revenues

As outlined in the 3rd R&O, we have excluded commission costs and location rents from both the previous and current cost studies, based on the FCC's determination that the PCC rate should be calculated using a marginal payphone location. The FCC has ruled that a "marginal payphone location is a location where the payphone operator is able to just recoup its costs, including earning a normal rate of return on the asset, but is unable to make payments to the location owner."[2] The FCC further defines a marginal payphone location as a location where "the payphone earns just enough revenue to warrant its placement, but not enough to pay anything to the premises owner,"[3] thus justifying the exclusion of commissions from the cost base. For the current cost-study, the RBOC Payphone Coalition, BellSouth Public, and Qwest reported average location rents and commissions of $26.39 per payphone per month. In our previous cost-study we calculated this amount to be $28.68 per payphone per month.

To be consistent with the FCC's definition of a marginal payphone location, it was necessary to reduce the commissions and location rents by the amount of semi-public revenues.[4] Semi-public revenues are payments from premises owners or operators to the members of the RBOC Payphone Coalition, BellSouth Public, and Qwest for the installation and operation of payphones. These payments may be required in locations where the payphones do not generate enough traffic to support payphone deployment, and essentially represent "negative" commissions. In the current cost-study the RBOC Payphone Coalition members, BellSouth

[2] 3rd R&O, 14 FCC Rcd at 2616, ¶139.

[3] 3rd R&O, ¶156.

[4] However, if semi-public revenues would have been treated as a direct reduction to the cost base in the cost-study and not as "negative" commissions, the resulting PCC for the current cost-study would remain at $.59.

Public, and Qwest reported average semi-public revenues of $13.10 per payphone per month.[5] In our previous cost-study this amount was calculated to be $13.82 per payphone per month.

In order to calculate the net commissions, we aggregated the commission costs/location rents and the semi-public revenues, resulting in the following net commissions:

	Current	Previous
Commission Costs/Location Rents per Payphone Per Month	$26.39	$28.68
Semi-Public Revenues per Payphone Per Month	$(13.10)	$(13.82)
Net Commissions per Payphone Per Month	$ 13.29	$14.86

Incidental Revenues

After quantifying the equipment, line, maintenance and SG&A costs and net commissions associated with payphone calls, we adjusted the cost base for identifiable incidental revenues associated with payphone booth advertising. RBOC Payphone Coalition members, BellSouth Public, and Qwest can earn revenues by providing advertising space in payphone booths or on their payphones. These revenues were treated as reductions to the cost base in the cost-study. For the current cost-study the reduction to the cost base for payphone booth advertising was $.74 per payphone per month, compared to $.34 in the previous cost-study.

[5] This number was calculated by dividing total payments by location owners by nine (nine months) and by the average total number of payphones in the cost-study.

Bad Debt

In the 3rd R&O, the FCC elected not to establish a cost element related to bad debt. The main reasons given by the FCC were as follows:

- Insufficient information on the record to account for the costs relating to bad debt,
- Assertion by interexchange carriers ("IXCs") that some alleged uncollectibles were legitimate billing disputes that arose during the PCC interim period, and
- Knowledge that a certain percentage of the uncollected PCC charge is due to billing errors by the payphone operators, as opposed to non-payment by IXCs.

Since the 3rd R&O, the RBOC Payphone Coalition members, BellSouth Public, and Qwest have developed more reliable bad debt information related to PCC calls during the effective period of the $.24 PCC charge. Utilizing the bad debt amounts related only to actual write-offs (i.e. previously recorded revenues that have been determined to be uncollectible and removed from the accounts receivable and bad debt reserve balances), including subsequent recoveries and excluding reserved amounts, for the current cost-study we calculated bad debt to be $.013 per call. This figure was quantified by dividing the total amount of actual bad debt write-offs by the total number of PCC calls. In the previous cost-study bad debt was calculated to be $.028 per PCC call.

Dial-Around Carrier Identification Costs

These charges are typically classified by the RBOC Payphone Coalition members, BellSouth Public, and Qwest as carrier identification costs or call detail record charges. This information is used to prevent fraud and determine the carrier that owns the calling card or 800/888 number, so the RBOC Payphone Coalition members, BellSouth Public, and Qwest can identify who is liable for a PCC charge.

Dial-around carrier identification costs are incurred as a result of PCC calls but not coin calls. For the current cost-study these costs amount to $.012 per PCC call, while in the previous cost-study these costs also amounted to $.012 per PCC call. These figures were quantified by dividing the total amount of dial-around carrier identification costs incurred by the total number of PCC calls.

Number of Stations (Payphones)

After the total payphone costs were identified, it was necessary to determine the number of stations or payphones deployed by each RBOC Payphone Coalition member, BellSouth Public, and Qwest in order to calculate a monthly cost per station. As of September 30, 2003 an aggregate total of 783,200 stations were reported to us by RBOC Payphone Coalition members, BellSouth Public, and Qwest. This represents a reduction of 26.2% from the 1,061,370 stations reported in the previous cost-study as of August 31, 2001. As expected, the number of stations has decreased from prior years, due largely to wireless penetration and affordability ("wireless substitution"), and other changes in the payphone business environment.

In order to calculate a per payphone cost during the nine-month period ended September 30, 2003, it was necessary to calculate an average number of total payphones during the period. Utilizing the December 31, 2002 aggregate total of 863,165, we calculated a simple average of 823,183 for the 9 month period as follows:

December 31, 2002 Total Aggregate Payphones	863,165
September 30, 2003 Total Aggregate Payphones	783,200
Sum	1,646,365
Divided by 2	823,183

Based on our analysis and review of the monthly payphone data submitted, the above calculation using a simple average is not materially different than alternative methods of calculating average payphones during the nine-month period (i.e., monthly average).

Number of Payphone and PCC Calls

In addition to collecting station information, we requested that each RBOC Payphone Coalition member, BellSouth Public, and Qwest provide us with call counts. Total calls were used to determine per-call costs for Equipment, Line, Maintenance and SG&A costs, and Incidental Revenues. Total PCC calls were used to determine a per call cost for Bad Debt and Dial-Around Carrier Identification costs.

The total number of calls included calls originating from both public and semi-public stations. Based on the information provided, we calculated a weighted average number of calls per month per station to be 190. This is a per station per month decrease of 24.9% and 60.3% from the previous cost-study's 253 average calls and the 478 average calls reported by the RBOC Payphone Coalition in 1998.[6] As noted above during the discussion on the number of stations, these decreases are also due largely to wireless penetration and affordability ("wireless substitution"), and other changes in the payphone business environment.

Number of Calls from a Marginal Payphone Location

As outlined in the 3rd R&O, and discussed above, in order to determine a PCC charge, the FCC stipulated that the calculation should be based on a marginal payphone location. For the RBOC Payphone Coalition, BellSouth Public, and Qwest, the average number of calls per month per marginal payphone amounted to 166 calls, and the average number of total calls amounted to 190 for the period 9 months ended September 30, 2003. Based on these figures, calls from a marginal payphone represented 87.1% of total average calls (difference due to rounding). This

[6] RBOC Coalition Sept. 3, 1998 *ex parte* letter to Magalie Roman Salas at 2. *Cf.* APCC Sept. 28 *ex parte* letter from R. Aldrich to Magalie Roman Salas.

is not inconsistent with data received in previous years (see below). The average marginal call volume of 166 was calculated assuming that a marginal payphone location would neither pay any location rents or commissions, nor earn any semi-public revenues. The calculation of the 166 calls is as follows:

Cost Component / Calls	Monthly Cost per Station
Equipment Costs, less Coin Related Installation	$28.04
Line Costs	$34.84
Maintenance Costs	$9.67
SG&A Costs	$18.20
Incidental Revenues	($ .74)
Subtotal of Recoverable Costs* (A)	$90.01
Net Commissions (B)	$13.29
Total (A) +(B) = (C)	$103.30
Net Commissions as a % of Total (B) / (C) = (D)	12.9%
Number of Average Calls per Station (E)	190
Number of Calls per Marginal Station (E) x (1 - (D))	166

* - Excludes Bad Debt, Dial-Around Carrier Identification Costs and Interest

In the 3rd R&O, the FCC used an average of 439 calls for a marginal payphone location in its determination of the PCC rate. This was the midpoint of 414 (the number of payphone calls that must be placed in order for the premises owner to not have to pay the LEC payphone service providers for the payphone) and 464 (the number of payphone calls that must be placed

in order for the LEC payphone service providers to begin paying a location payment to the premises owner) as previously reported by the RBOC Payphone Coalition.

Based on information provided by the RBOC Payphone Coalition in previous years, the average number of total calls from an RBOC Payphone Coalition member payphone was 478. Based on the figures provided by the RBOC Payphone Coalition members, and accepting the FCC's midpoint of 439 calls for a marginal payphone location, calls from the marginal location represented 91.8% of total average calls. Utilizing the RBOC Payphone Coalition submitted number of 414 calls from previous years, calls from the marginal location represented 86.6% of total average calls.[7] This relationship is essentially unchanged at 87.1% based on the current cost-study data.

[7] 3rd R&O, ¶148.

B. Calculation of Cost-Based PCC Rate

Employing the cost-based methodology in the 3rd R&O, we used the financial and operational data discussed above to calculate the current PCC charge at a marginal payphone location as follows:

Cost Component / Calls	Monthly Cost per Station
Equipment Costs, less Coin Related Installation	$28.04
Line Costs	$34.84
Maintenance Costs	$9.67
SG&A Costs	$18.20
Incidental Revenues	($ .74)
Sub-Total of Recoverable Costs	$90.01
Divide By: Number of Calls per Marginal Station	166
PCC before Dial-Around Carrier Identification Costs, Bad Debt and Interest	$.543
Dial-Around Carrier Identification Costs per PCC Call	$.012
Bad Debt Costs per PCC Call	$.013
Interest for 4 Months	$.021
PCC Charge	$.59

As noted, the calculation above excludes net commissions and uses calls from a marginal location. However, the PCC charge calculation is almost identical, should the decision be made that net commissions are includible and total average calls (as opposed to calls from a marginal location) are used. This calculation is:

Cost Component / Calls	Monthly Cost per Station
Equipment Costs, less Coin Related Installation	$28.04
Line Costs	$34.84
Maintenance Costs	$9.67
SG&A Costs	$18.20
Net Commissions	$13.29
Incidental Revenues	($ .74)
Sub-Total of Recoverable Costs	$103.30
Divide By: Weighted Average Number of Calls per Station	190
PCC before Dial-Around Carrier Identification Costs, Bad Debt and Interest	$.543
Dial-Around Carrier Identification Costs per PCC Call	$.012
Bad Debt Costs per PCC Call	$.013
Interest for 4 Months	$.021
PCC Charge	$.59

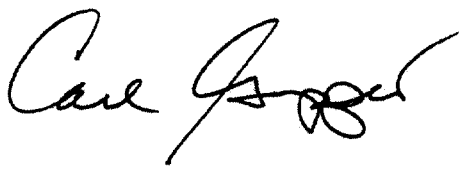
The difference between the $.24 PCC charge calculated in the 3rd R&O and the $.59 PCC charge in our current cost-study is attributable mainly to the decrease in payphone call volumes, partially offset by the decline in Line and Maintenance costs over time. Reviewing the first

scenario above, which excludes commissions and uses call volumes from a marginal location, the total recoverable costs, net of incidental revenues and before dial-around carrier identification costs, bad debt and interest of $90.01 is actually 10.2% less than the recoverable cost amount of $100.21, after excluding FLEX ANI costs, calculated by the FCC in the 3rd R&O, and 4.9% less then the recoverable cost amount of $94.67 in the previous cost-study.

Attached as Exhibit A is my curriculum vitae.

KPMG LLP

By



Carl R. Geppert

January 6, 2004

Exhibit A

CARL R. GEPPERT
Partner, Industry Director
Americas Communications Practice

RELEVANT SKILLS AND EXPERIENCE

Carl is a Partner and Industry Director in KPMG LLP's Americas Communications Practice. He has 23 years of experience in assisting communications companies address significant financial, regulatory, information technology and business issues. Carl is a member of KPMG's Global Communications Industry Steering Committee, responsible for overseeing the delivery of services to KPMG communications industry clients on a global basis. Carl is also the Global Partner in Charge of KPMG's Margin Enhancement (ME) practice.

Products offered through the Margin Enhancement (ME) practice are designed to help communications companies effectively manage their revenue-related business risks to enhance revenue, manage costs and positively impact profitability. ME focuses on cross-functional revenue and cost issues involving the effective integration of critical business processes and systems.

Carl has extensive experience in providing regulatory accounting, audit and consulting services to clients in the United States and globally. His experience includes:

- Serves as KPMG's primary interface with the Federal Communications Commission (FCC) in addressing accounting, cost allocation, affiliate transaction, costing and pricing issues. He has served as a representative on the Telecommunications Subcommittee of the AICPA's Public Utilities Committee. Has conducted special seminars regarding the Part 64 Rules and audit requirements for the FCC Accounting Safeguards Division and for several audit and non-audit clients. Consults regularly with communications clients regarding regulatory matters, including issues involving the proper application of the Part 32 accounting and the Part 64 cost allocation rules.

- Has served as the overall engagement partner for the financial statement and Part 64 cost allocation audits at two Regional Bell Operating Companies (RBOCs), Qwest Communications International Inc. (formerly U S WEST) and Ameritech Corporation. He has directed numerous attest engagements and advisory projects related to regulatory matters, including examinations of merger/ Section 271 terms and conditions imposed by the FCC, billing and cost allocation examinations required by various state public utility commissions (PUCs), and access charge billing and cost reconciliations required by the FCC. Has served as the concurring review partner for several large communications companies, including GTE Corporation, ALLTEL Corporation, SNET Communications, the National Exchange Carrier Association (NECA) and the Universal Service Administrative Company (USAC).

- Has developed cost allocation and product profitability models for several wireline and wireless carriers to assist in the evaluation of the profitability of retail versus wholesale

operations, regulated versus nonregulated activities, basic local services subject to Universal Service Funding versus competitive services, specific state regulated product and service categories, inside wire installation and maintenance services in multiple state jurisdictions, nonregulated telecommunications carrier affiliate operations and directory publishing operations.

- Directed work for the RBOC payphone coalition from May 1996 to the present. Has filed several affidavits and participated in ex parte meetings with the FCC, addressing pay telephone per call compensation costing and pricing issues and asset reclassification/cost accounting safeguard issues in response to Section 276 of the Telecommunications Act of 1996.

- Authored position papers entitled "Accounting Simplification in the Telecommunications Industry," filed with the FCC on July 15, 1998, and the "Supplement to July 15, 1998 Position Paper - Accounting Simplification in the Telecommunications Industry," filed with the FCC on November 10, 1998, in connection with the FCC's 1998 Biennial Regulatory Review pursuant to Section 11 of the Communications Act, as amended, and its Notice of Proposed Rulemaking in CC Docket No. 98-81. Participated in ex parte meetings with the Accounting Safeguards Division, Common Carrier Bureau and each FCC Commissioner's office to review the recommendations contained in the position paper.

- Has served as an accounting and consulting expert in several regulatory proceedings and has provided expert affidavits and testimony. Recent engagements include:

  - Served as the consulting expert responsible for the analysis of a wireless carrier's wholesale and retail costs and revenues and the appropriateness of wholesale rates charged to third party resale carriers.

  - Served as the testifying expert in a case involving the appropriateness of pay telephone per call compensation paid by a long-distance carrier to independent payphone service providers.

  - Testified in State of California in conjunction with Roseville Telephone Company regulatory proceeding regarding cost allocation, affiliate transaction and other matters.

  - Filed expert affidavits and other correspondence with the FCC in relation to the Commission's RBOC continuing property record audits and met extensively with each FCC Commissioner's office as well as representatives from both the U.S. Senate and House of Representatives to review the issues surrounding such audits.

  - Filed an expert affidavit and participated in ex parte meetings with the FCC in conjunction with the United States Telephone Association's Petition for Reconsideration of the FCC's Second Report and Order in CC Docket No. 96-149.

  - Filed an expert affidavit in conjunction with a U S WEST Communications state of Washington rate proceeding regarding regulatory policies and rate levels.

- Prepared and filed an expert report addressing the nature and proper accounting treatment of access charge billings, specifically the pre-subscribed interexchange carrier charge (PICC) and universal service fund charge (USF).

- Directed a project to assess the profitability of inside wire installation and maintenance services and provided testimony and expert affidavits in proceedings for Ameritech's telephone operating companies in Illinois, Indiana, Michigan, Ohio and Wisconsin.

- Authored comments in several FCC proceedings, most recently the proceeding to implement the Section 272 biennial audit requirements pursuant to CC Docket No. 96-150.

- Directed U.S. project teams participating in studies performed in China, Spain, France and Germany to assist in the development of interconnection prices and regulatory models by analyzing regulatory models, regulatory accounting and cost allocation rules and regulations, interconnection costing and pricing methods and cost of capital methodologies used in various countries.

- Served as subject matter expert in U.S. regulatory and costing matters in connection with a project to examine accounting separations processes for the European Commission and develop interconnection policies and procedures.

- Directed projects to analyze the fair market value of services provided between local exchange carriers and their non-regulated affiliates in accordance with the FCC's affiliate transaction rules as modified in CC Docket No. 96-150. Has consulted with numerous clients on the application of the FCC's affiliate transaction rules.

- Assisted in rate filings by reviewing forecasted data, analyzing historical data and developing and reviewing expert testimony on a variety of complex accounting and tax issues. Developed a P.C.-based Pricing Analysis Tool to assist companies evaluate alternative regulatory strategies at the Federal and state levels.

- Carl has directed numerous projects to analyze the operating effectiveness and internal control structure over key revenue processes and implement effective solutions to enable clients to more effectively manage their revenue business risks. Carl has extensive consulting experience in working with both incumbent and competitive wireline and wireless carriers in addressing risks related to retail, wholesale, interconnection/access and miscellaneous (regulated and nonregulated) revenues. Carl has consulted extensively with clients in the areas of service pricing and costing, customer care/ service order processing, provisioning, customer and carrier access billing, accounts receivable management, billing and collections, and separations and settlements. He has authored articles on margin enhancement and revenue assurance in *Telephony, Billing World, teledotcom and Telecommunications* magazines as well as several industry white papers. He is a frequent speaker at industry conferences and seminars addressing margin enhancement, billing and revenue assurance topics.

REPRESENTATIVE CLIENTS

Qwest Communications (U S WEST)
KPNQwest
Ameritech
BellSouth
SBC Communications
SBC Long Distance
Sprint
Verizon
Verizon Wireless
NECA
USAC
U. S. Telecom Association
ATU Telecommunications
ALLTEL
Aria West International
Cable & Wireless
Citizens Communications
Covad Communications
Global Crossing
ICG Communications
J-PHONE/Vodafone
Level 3 Communications
Optus Communications
Roseville Communications

EDUCATIONAL AND PROFESSIONAL BACKGROUND

Carl holds Bachelor and Master of Science degrees in accounting from the University of Illinois. He is a CPA in the states of Colorado and Illinois and is a member of the American Institute of Certified Public Accountants, Colorado CPA Society, Illinois CPA Society and the Accounting and Tax Committee of the Illinois Telephone Association.